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September 2009

# DEFENSE CONTRACTING INTEGRITY

## Opportunities Exist to Improve DOD's Oversight of Contractor Ethics Programs

**G A O**Accountability \* Integrity \* Reliability

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Report Documentation Page				Form Approved OMB No. 0704-0188	
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1. REPORT DATE <b>SEP 2009</b>		2. REPORT TYPE		3. DATES COVERED <b>00-00-2009 to 00-00-2009</b>	
4. TITLE AND SUBTITLE <b>Defense Contracting Integrity. Opportunities Exist to Improve DOD's Oversight of Contractor Ethics Programs</b>				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) <b>U.S. Government Accountability Office, 441 G Street NW, Washington, DC, 20548</b>				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT <b>Approved for public release; distribution unlimited</b>					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT <b>Same as Report (SAR)</b>	18. NUMBER OF PAGES <b>49</b>	19a. NAME OF RESPONSIBLE PERSON
a. REPORT <b>unclassified</b>	b. ABSTRACT <b>unclassified</b>	c. THIS PAGE <b>unclassified</b>			



Highlights of [GAO-09-591](#), a report to congressional committees

## Why GAO Did This Study

Until recently, ethics programs and practices of defense contractors were self-policed. Given the significant sums spent to acquire goods and services, the Federal Acquisition Regulation (FAR) was amended twice starting in December 2007 to first mandate and later amplify contractor ethics program rules. Before FAR changes were finalized in December 2008, Congress required GAO to report in 2009 on the ethics programs of major defense contractors. This report (1) describes the extent that contractors had ethics programs before the finalization of the FAR rules that included practices consistent with standards now required by the FAR and (2) assesses the impact the new FAR rules have on Department of Defense (DOD) oversight of contractor ethics programs. To do this work, in September 2008 GAO surveyed all 57 contractors—those receiving more than \$500 million in 2006 DOD contract awards—and interviewed DOD contractor oversight agency officials on the impact of the new FAR rules on oversight.

## What GAO Recommends

GAO recommends four actions aimed at improving oversight of ethics programs during contract administration and DOD hotline poster requirements for contractors to ensure that whistleblower protections are communicated. DOD concurs with GAO's recommendations.

View [GAO-09-591](#) or key components. For more information, contact John Needham at (202) 512-4841 or [needhamjk1@gao.gov](mailto:needhamjk1@gao.gov). To view the e-supplement online, click [GAO-09-646SP](#)

# DEFENSE CONTRACTING INTEGRITY

## Opportunities Exist to Improve DOD's Oversight of Contractor Ethics Programs

### What GAO Found

All 57 contractors responded to GAO's survey, and 55 reported having ethics programs that include many of the practices consistent with standards now required for compliance with the FAR. The ethics practices information GAO obtained was from before the FAR rules were finalized and thus was not designed to test contractor compliance with the rules that came later.

#### Contractor Responses on Ethics Practices Now Required by the FAR

FAR standard	Contractors reporting these practices
<b>Code of business ethics and conduct</b>	<ul style="list-style-type: none"> <li>- 55 have written codes</li> <li>- 54 provide copies to employees</li> </ul>
<b>Ethics awareness and compliance program</b>	<ul style="list-style-type: none"> <li>- 55 have ongoing programs</li> <li>- 51 require ethics training for employees and managers working on DOD contracts</li> <li>- 55 use other mechanisms to communicate employee ethics awareness and compliance</li> </ul>
<b>Internal control system</b>	
High level of management oversight	<ul style="list-style-type: none"> <li>- 52 have an office or individual charged with implementing the ethics program</li> <li>- 25 report quarterly top management oversight of ethics program managers</li> </ul>
Periodic reviews, audits, or both	<ul style="list-style-type: none"> <li>- 52 have internal reviews or audits to test ethics program</li> <li>- 47 periodically assess risks of improper or criminal conduct</li> </ul>
Mechanisms for reporting misconduct	<ul style="list-style-type: none"> <li>- 55 have internal reporting mechanisms, such as hotlines</li> <li>- 54 have a policy for employees to report anonymously or confidentially</li> </ul>
Disciplinary systems	<ul style="list-style-type: none"> <li>- 52 have codes that provide examples of disciplinary consequences, such as counseling and termination</li> </ul>
<b>Timely disclosure</b>	<ul style="list-style-type: none"> <li>- Before FAR rule, 34 had a formal policy for voluntary disclosure to DOD of contract-related violations</li> <li>- After FAR rule, 4 contractors GAO visited changed disclosure policy to comply with new mandatory disclosure requirement</li> </ul>

Source: GAO analysis of contractor survey.

In response to the new FAR rules, DOD has made two key oversight improvements by revising its contract audit guidance to cover the new ethics requirements and establishing the Contractor Disclosure Program to implement the mandatory disclosure requirement. However, opportunities exist to improve DOD's oversight in two other key areas. For example, in verifying implementation of contractor ethics programs during contract administration, the impact of the FAR rules on oversight at this point is negligible. GAO found that DOD had no plans to change contract administration offices' oversight because authority for oversight is not explicit nor is organizational responsibility clear. Also, with regard to contractors' hotline poster displays, the new FAR rules could reduce DOD's awareness of potential violations. The rules exempt contractors with ethics programs that include their own hotlines from the requirement to display DOD hotline posters. If contractor employees report violations to company hotlines instead of DOD hotlines, the employees do not receive the same protections from whistleblower laws. Whistleblower protections for employees unaware of the DOD hotline could be jeopardized.

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## Abbreviations

ACO	administrative contracting officer
AT&L	Acquisition, Technology, & Logistics
CAM	Defense Contract Audit Agency, <i>Contract Audit Manual</i>
CAO	contract administration office
DAR	Defense Acquisition Regulation
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DOD	Department of Defense
DOJ	Department of Justice
DOD IG	Department of Defense Inspector General
FAR	Federal Acquisition Regulation
GAO	Government Accountability Office

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United States Government Accountability Office  
Washington, DC 20548

September 22, 2009

## Congressional Committees

In fiscal year 2008, the Department of Defense (DOD) spent more than \$387 billion for goods and services from more than 85,000 contractors. Given the magnitude of taxpayer money at stake, it is essential that defense contractors conduct their business operations with integrity. In the last several years there have been a number of cases of fraud, waste, and abuse in wartime contracting and even some high-profile criminal and civil convictions of large defense contractors because of procurement integrity and foreign corrupt practices violations. These procurement fraud cases heightened concerns in Congress and the executive branch about the adequacy of defense contractors' ethics programs in preventing or addressing misconduct that could put billions of dollars of contracted goods and services at risk.

In the past, DOD's policy under the Defense Federal Acquisition Regulation Supplement (DFARS) encouraged contractors to have written ethics policies and recommended practices, such as ethics training for all employees and hotlines or other internal mechanisms for them to report suspected misconduct.<sup>1</sup> Essentially, defense contractor ethics programs were voluntary and self-policed. Moreover, our prior work raised concerns that DOD lacked adequate oversight of its contractors' ethics programs, recommending that enhanced knowledge of contractor ethics programs would enable DOD to assess whether the public trust is protected.<sup>2</sup>

Given the significant sums of federal dollars spent by agencies to acquire goods and services, and the need to establish a clear and consistent policy regarding contractor code of ethics and business conduct, the Federal Acquisition Regulation (FAR) was amended twice to address contractor

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<sup>1</sup> DFARS is a supplement to the Federal Acquisition Regulation (FAR) that provides DOD-specific regulations. Among its requirements, DFARS contains DOD-wide policies and deviations from FAR requirements.

<sup>2</sup> GAO, *Defense Ethics Program: Opportunities Exist to Strengthen Safeguards for Procurement Integrity*, [GAO-05-341](#) (Washington, D.C.: Apr. 29, 2005). In concurring with this report, DOD stated that the recommendation to assess contractor ethics programs was currently implemented when contracting officers, before awarding a contract, make an affirmative determination of responsibility, which includes consideration of the potential contractor's business practices and the potential contractor's integrity.

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ethics programs. In December 2007 and again in December 2008, the FAR was amended first to mandate and then to amplify governmentwide ethics program requirements for certain contractors.<sup>3</sup> Contractors' internal programs must now include an ethics and compliance system with several practices aimed at preventing and detecting misconduct and at promoting an organizational culture that encourages ethical conduct and a commitment to compliance with the law. Before FAR changes were finalized in late 2008, Congress included a provision in the National Defense Authorization Act for Fiscal Year 2008 requiring us to report on the internal ethics programs of major defense contractors—defined as any company that received more than \$500 million in DOD contract awards in fiscal year 2006—and the extent to which DOD monitors or approves them.<sup>4</sup> In January 2009, we briefed your committees on the preliminary results regarding the reporting requirements specified in the act. Taking into consideration the new FAR contractor ethics program rules, which are very similar to some of the reporting requirements specified in the act,<sup>5</sup> this report (1) describes the extent to which contractors had ethics programs before the finalization of the FAR rules that included practices consistent with standards now required by the FAR and (2) assesses the impact the new FAR rules have on DOD oversight of contractor ethics programs.

To select contractors for review, we used DOD's contract award data and identified 57 major defense contractors receiving more than \$500 million in fiscal year 2006 for review. To obtain information on contractor ethics programs and practices, in September 2008 we surveyed all 57 contractors. We also obtained corroborating documentation for various practices—including those consistent with the FAR's standards, such as management oversight and ethics and compliance training—and information about the benefits to contractors and the challenges they face in implementing the new FAR ethics rules. We analyzed responses from all 57 contractors and

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<sup>3</sup> Since December 24, 2007, contractors receiving awards worth more than \$5 million and involving work in excess of 120 days have been required to have a written code of business ethics and conduct. However, until further amended effective December 12, 2008, the rule did not apply to contracts for commercial items or to contracts performed outside the United States. 72 Fed. Reg. 65873-82 (Nov. 23, 2007).

<sup>4</sup> The National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181 § 848.

<sup>5</sup> App. I provides a side-by-side comparison in table 10 of the ethics program elements identified in § 848 for inclusion in this report with those contractor ethics program elements now required by the FAR, all of which became the basis for our survey on major defense contractors' ethics programs. Pub. L. No. 110-181 § 848 (2008).

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reviewed the FAR Council's disposition of public comments considered as part of the rulemaking process for additional perspectives on benefits to contractors and challenges they face implementing new ethics program rules.<sup>6</sup> While we reviewed the contractors' self-reported practices for consistency with the FAR rules that came later, we did not test them for effectiveness or compliance. We selected a nongeneralizable sample of four contractors for site visits in order to review in detail implementation practices for some of the ethics program policies or procedures described in their survey responses. We chose these four contractors because (1) they ranked among the top 15 contractors in terms of dollar value of fiscal year 2006 DOD contract awards and (2) their survey responses indicated that they had such policies or procedures in use.

To assess the impact the new FAR contractor ethics rules have on DOD, we focused on defense and military organizations responsible for oversight and investigation of contractor operations and improper business practices.<sup>7</sup> These organizations included the (1) Defense Contract Management Agency (DCMA); (2) Defense Contract Audit Agency (DCAA); (3) DOD Office of the Inspector General (DOD IG); (4) Air Force, Army, and Navy offices responsible for suspension and debarment; and (5) Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L). We interviewed senior procurement officials; general counsel; and contract administration, audit, and investigative service officials concerning these agencies' roles and responsibilities for monitoring or approving contractor ethics programs. Through interviews and information obtained from these officials, we obtained views and reviewed supporting documentation concerning the impact the new FAR rules have had or could have on DOD contractor oversight activities related to monitoring contractors' compliance with ethics program practices required by the new rules. We did not test DOD agencies'

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<sup>6</sup> The FAR Council—whose members include the DOD Director of Defense Procurement and Acquisition Policy, the National Aeronautics and Space Administration Associate Administrator for Procurement, and the General Services Administration Chief Acquisition Officer—oversees development and maintenance of the FAR. The Office of Federal Procurement Policy Administrator in the Office of Management and Budget serves as chair of the FAR Council, which meets quarterly to discuss and resolve significant or controversial FAR changes.

<sup>7</sup> For purposes of this report, an improper business practice is defined as a known or suspected violation of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in title 18 of the United States Code or a violation of the civil False Claims Act.



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effectiveness in implementing their oversight activities related to monitoring contractor ethics programs.

We conducted this performance audit from May 2008 through August 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Appendix I provides additional details on our scope and methodology, including a list of the 57 contractors reviewed.

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## Background

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### Defense Contractor Ethics Programs and DOD Oversight before New FAR Rules

Before the FAR changes in December 2007, DFARS provided that contractors must conduct themselves with the highest degree of integrity and honesty.<sup>8</sup> Specifically, defense regulations provided that contractors should have (1) a written code of ethical conduct; (2) ethics training for all employees; (3) periodic reviews of compliance with their code of ethical conduct; (4) internal audits, external audits, or both; (5) disciplinary action for improper conduct; (6) timely reporting to appropriate government officials of any suspected violation of law regarding government contracts; and (7) full cooperation with any government agencies responsible for either investigation or corrective action.<sup>9</sup> While defense regulations provided that contractors should have such elements, they were not mandatory. As a result, under DFARS and until the FAR rules established mandatory ethics program requirements, DOD relied on contractor self-governance—through which a company decided if and how to implement and enforce ethical conduct.

Oversight and management of DOD contracting activities is shared among various organizations. Collectively, these organizations help detect instances of fraud, waste, and abuse; try to prevent them from happening;

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<sup>8</sup> 48 C.F.R. § 203.7000 (2007).

<sup>9</sup> 48 C.F.R. § 203.7001 (2007).

or are involved in correcting policies and procedures when they occur.<sup>10</sup> For example, the Office of the Under Secretary of Defense for AT&L provides policy, guidance, and oversight to acquisition functions. Other DOD organizations may examine contractors' ethics programs under a range of authorities for contract administration and audit services. Table 1 shows DOD organizations involved in overseeing and managing contracting activities and their primary responsibilities in examining contractors' ethics programs.

**Table 1: DOD Organizations Responsible for Oversight and Management of DOD Contracting Activities in Which Contractor Ethics Programs May Be Examined**

DOD organization	Responsibility
<b>Contract audit services and administration</b>	
DCAA	Located on-site at contractor facilities for ongoing contract audit purposes, DCAA audits internal control systems—including the contractor's control environment for integrity and ethical values—every 3 to 4 years, and reports on adequacy of controls. According to DCAA, the contractor's control environment has a pervasive influence on its business activities and is the foundation for all other internal control systems, such as billing and labor. DCAA also makes investigation referrals, usually to the DOD IG, regarding situations that reasonably appear to entail fraud that it encounters during its contract audits.
DCMA	DCMA is a combat support agency responsible for ensuring the integrity of contractual processes and provides a broad range of contract and procurement management services to DOD buying organizations. As of December 2008, DCMA reports managing 291,000 prime contracts valued at \$950 billion. Also located on-site for ongoing contract administration purposes, as needed, DCMA monitors ethics program corrections in response to DCAA-identified deficiencies.
<b>Improper business practices</b>	
DOD IG	DOD IG conducts audits and oversees matters relating to detection and prevention of fraud, waste, and abuse, and collaborates with numerous other DOD entities, as many activities are involved in addressing these issues across DOD. DOD IG does not monitor contractor ethics programs per se, but may get insight through oversight of and follow-up on irregularities or misconduct reported through DCAA, the Defense Hotline Program, and the DOD Contractor Disclosure Program.
Air Force, Army, and Navy offices of general counsel suspension and debarment officials	During any administrative suspension or debarment proceeding or in reaching an administrative settlement, the contractor's ethics program may come under the review and approval of the agency's suspension and debarment official. For example, under separate administrative compliance agreements from March 2005 through October 2007, the Air Force and Army suspension and debarment officials approved changes in and policed compliance with ethics programs of two contractors in our study.

Sources: DOD and FAR (information); GAO (analysis and presentation).

<sup>10</sup> See also GAO, *Contract Management: DOD Vulnerabilities to Contracting Fraud, Waste, and Abuse*, [GAO-06-838R](#) (Washington, D.C.: July 7, 2006).

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## Concerns over Procurement Fraud Trends Prompt FAR Contractor Ethics Rules

A number of cases involving fraud in wartime contracting in Iraq, Kuwait, and Afghanistan and recent scandals involving high-profile defense contractors have prompted significant changes in procurement fraud investigations, enforcement initiatives, legislation, and regulation. By 2007, in view of the trend, the FAR Council commented that the DFARS provision that contractors should have specific elements of an ethics program was no longer considered strong enough to increase contractor compliance with ethical rules of conduct.<sup>11</sup>

To address this problem, the FAR Council changed the regulations. After conducting an extensive proposed rulemaking and public comment process from February 2007 through November 2008, the FAR Council twice amended the FAR to impose new ethics requirements on government contractors. The initial rule—effective in December 2007—created a new FAR subpart that requires government contractors to have written codes of business ethics and ethics compliance training programs for contractor employees and to post “fraud hotline” posters at contractor work sites to encourage contractor employees to report fraudulent activity in connection with performance and award of government contracts.<sup>12</sup>

However, in December 2008 certain shortcomings in the initial contractor ethics rules were addressed in further amendments to the FAR.<sup>13</sup> For example, public concerns over the first rule’s exemption connected to overseas contracting prompted elimination of this exemption in the second rule, and as of December 2008, overseas and commercial contractors are now required to maintain written codes of business ethics and conduct. In addition, the amended FAR contractor ethics rules now require contractors to disclose violations of criminal law involving fraud, conflict of interest, bribery, or gratuity violations or violations of the civil False Claims Act (31 U.S.C. 3729-3733) in connection with award or performance of government contracts and subcontracts. It should be noted that these requirements are implemented by contract clause and are

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<sup>11</sup> 72 Fed. Reg. 65876 (Nov. 23, 2007).

<sup>12</sup> 72 Fed. Reg. 65873-82 (Nov. 23, 2007).

<sup>13</sup> On June 30, 2008, Congress enacted the Close the Contractor Fraud Loophole Act as part of the Supplemental Appropriations Act, 2008. The act requires the FAR to include provisions that require timely notification by federal contractors of violations of federal criminal law or overpayments in connection with the award or performance of covered contracts or subcontracts, including those performed outside the United States and those for commercial items. Supplemental Appropriations Act, 2008, Pub. L. No. 110-252, Title VI, ch. 1.

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mandatory.<sup>14</sup> The amended rules also specifically subject contractors to suspension and debarment from government contracting for knowingly failing to disclose such violations and failing to disclose receipt of overpayments on government contracts in a timely manner.

The FAR changes effective in December 2008 also enhance provisions for sound ethics business practices by specifically requiring the establishment of internal control systems for

- facilitating discovery of improper conduct,
- ensuring that corrective measures are promptly carried out, and
- otherwise promoting an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

In publishing the December 2008 rule's amplified requirements, the FAR Council stated that the U.S. Sentencing Commission's federal sentencing guidelines are the source of the FAR text, which provides guidance for contractors consistent with the guidelines on effective compliance and ethics programs for organizations. Among other things, the sentencing guidelines state that an ethics and compliance program should be reasonably designed, implemented, and enforced so that it is generally effective in preventing and detecting criminal conduct. Notably, the sentencing guidelines also state that the failure to prevent or detect a particular offense does not necessarily mean that the program is generally ineffective in preventing and detecting criminal conduct.

According to the FAR Council, the final rule reflects standards across four broad components and establishes a framework for institutional ethics management and disclosure, but does not prescribe specific ethical requirements. Contractors are free to establish the appropriate ethical standards for their businesses. For a more detailed description of the final rule's establishment of standards across four broad components, see appendix II.

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<sup>14</sup> FAR § 3.1004.

## Contractors Report Using a Range of Ethics Program Practices Now Required by the FAR

In September 2008 and before the FAR rules were finalized, to identify contractor ethics program practices, we surveyed all 57 contractors to obtain information on the extent to which their programs included practices required or proposed in the FAR or otherwise addressed in congressional requirements for this report. As summarized in table 2, nearly all of the 57 contractors responding to our survey report using many of the ethics practices consistent with standards now required by the FAR. The ethics program practices information we obtained was not designed to test contractor compliance with the rules that came later.

**Table 2: Contractor Responses on Ethics Practices Now Required by the FAR**

FAR standard	Contractors reporting these practices
<b>Code of business ethics and conduct</b>	<ul style="list-style-type: none"> <li>• 55 have written codes</li> <li>• 54 provide copies to employees</li> </ul>
<b>Ethics awareness and compliance program</b>	<ul style="list-style-type: none"> <li>• 55 have ongoing programs</li> <li>• 51 require ethics training for employees working on DOD contracts</li> <li>• 55 use other mechanisms to communicate employee ethics awareness and compliance</li> </ul>
<b>Internal control system</b>	
High level of management oversight	<ul style="list-style-type: none"> <li>• 52 have an office or individual charged with implementing the ethics program</li> <li>• 25 report quarterly top management oversight of ethics program managers</li> </ul>
Periodic reviews, audits, or both	<ul style="list-style-type: none"> <li>• 52 have internal audit functions that review ethics program effectiveness</li> <li>• 47 periodically assess risks of improper or criminal conduct</li> </ul>
Internal mechanism for reporting misconduct	<ul style="list-style-type: none"> <li>• 55 have internal reporting mechanisms, such as hotlines</li> <li>• 54 have a policy for employees to report misconduct anonymously or confidentially</li> </ul>
Disciplinary systems	<ul style="list-style-type: none"> <li>• 52 have codes that provide examples of disciplinary consequences, for example, warning, counseling, and employment termination</li> </ul>
<b>Timely disclosure</b>	<ul style="list-style-type: none"> <li>• Before FAR rule, 34 had a policy for voluntary disclosure to DOD of contract-related violations and misconduct</li> <li>• Post FAR rule, 4 contractors we visited for follow-up changed disclosure policy and procedure to comply with new mandatory disclosure requirement</li> </ul>

Source: GAO analysis of contractor survey.

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Notes: At the time of our survey, contracts for the acquisition of commercial items and those that would be performed entirely outside the United States were exempt from the requirements shown in the table, and none of the contractors were required to timely disclose credible evidence of certain violations of federal criminal law or of the civil False Claims Act. In addition, all small businesses are exempt from the FAR requirements for an ethics awareness and compliance program and an internal control system. In this table and throughout this report, we present data on the number of affirmative responses and not data on the number of "no" and "don't know" responses or the number of contractor nonresponses to a question.

Views of contractors surveyed were mixed with regard to the benefits and challenges they face in implementing the FAR contractor ethics rules. Contractors responding to our survey cited several expected benefits and challenges of the new ethics rules. Other benefits and challenges were attributed by the FAR Council to public comments from contractor industry and other sources when finalizing the new FAR contractor ethics rules in 2008. Some of these benefits and challenges are highlighted in table 3.

**Table 3: Highlights of GAO Contractor Survey and FAR Public Comments regarding Benefits to Contractors and Challenges They Face in Implementing FAR Ethics Rules**

<b>Contractor benefits from implementing FAR ethics rules</b>	
<ul style="list-style-type: none"> <li>• Codify good business practices for all contractors and reinforce importance that all businesses conduct themselves in an ethical manner.</li> <li>• Contribute to a company culture emphasizing business integrity.</li> <li>• Provide standard and create a level playing field.</li> <li>• Build employee trust and confidence.</li> <li>• Reduce contractor liability and risk.</li> <li>• Assist contractors subject to similar responsibilities or federal sentencing guidelines if accused of crimes.</li> <li>• Benefit the government procurement process as a whole.</li> <li>• Reinforce companies' compliance standards and inhibit unethical conduct.</li> <li>• Provide basis for government partners to evaluate contractor's responsibility and are meaningful for enforcement when something goes wrong.</li> </ul>	
<b>Contractor challenges in implementing FAR ethics rules</b>	
Mandatory disclosure	
<ul style="list-style-type: none"> <li>• In contrast to existing government programs and contractor initiatives offering ample incentives to voluntarily report contract violations, mandatory disclosure may eliminate the ability of a contractor to claim the benefit of "timely and voluntary disclosure" to the government if the contractor is charged with a crime.</li> <li>• Failure to disclose an overpayment on a government contract may create operational difficulties because (1) contracts are subject to reconciliation processes with payments audited and adjusted over time and (2) the routine nature of contract payment issues, which are daily events, with errors on both sides, is simply unworkable.</li> <li>• Challenge to interpret vague language, such as "suspected," "cooperation," "timely," and "reasonable grounds to believe," may tie up government resources in meaningless legal trivia.</li> <li>• If contractor employees know that everything they report will be passed on to the government, this may result in less reporting up the chain of the company rather than more and could decrease rather than enhance cooperation with company ethics compliance efforts.</li> </ul>	
Other challenges	
<ul style="list-style-type: none"> <li>• Expanding our awareness program to keep pace with our company growth.</li> <li>• Ensuring sufficient training for significant number of employees.</li> <li>• Executing the requirement for checking the existence of subcontractor ethics awareness and internal control systems.</li> <li>• Utilizing a covered subcontractor outside the United States, as we would expect that many foreign companies may not have programs that are as stringent as is required by the FAR, and it could be difficult in some countries to fund a subcontractor with such a program.</li> </ul>	

Sources: GAO analysis of contractor survey and 73 Fed. Reg. 67064-93.

With regard to the new FAR rule's mandatory timely disclosure of certain contract-related violations of criminal law or the False Claims Act, several contractors responding to our survey as well as industry concerns cited in public comments indicated that contractors would face significant difficulty in implementing those requirements. In response to these concerns, the FAR Council revised key aspects of the final rule regarding timely disclosure, including to

- 
- more closely focus the situations that must be disclosed by limiting violations of criminal law to certain violations involving fraud, conflict of interest, bribery, or gratuity violations that have occurred in connection with the award, performance, or closeout of a contract or subcontract;
  - make “credible evidence” the standard for when timely disclosure should occur;
  - add clarification that if a violation relates to more than one government contract, the contractor may make the disclosure to the agency officials responsible for the largest dollar value contract affected by the violation; and
  - limit the application of suspension or debarment to undisclosed overpayment cases in which the amount is significant.<sup>15</sup>
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## Contractors’ Ethics Program Practices

Highlighted below is some of the aggregated analysis resulting from the survey about contractors’ ethics practices. A more complete tabulation of survey questions together with tables indicating the levels of response can be found in the e-supplement to this report, found on our Web site at <http://redesign-www.gao.gov/special.pubs/gao-09-646sp/index.html>.

## Nearly All Contractors Report Having a Code of Business Ethics and Conduct

One purpose of a code of conduct can be to communicate a company’s statement of ethical values and integrity as established by top leadership. Although the FAR does not specify what topics a contractor must include in its code of conduct, they can cover a broad range of business ethics and conduct standards, such as conflict of interest, relationships with vendors, and compliance with government contracting requirements for procurement integrity, classified information, and recruiting and employing current or former government personnel, according to sources

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<sup>15</sup> In finalizing the rule, the FAR Council declined to expressly define “significant overpayment” in response to concerns raised in the public comments. Instead, FAR Council comments indicated that “significant overpayment” implies more than just dollar value and depends on the circumstances of the overpayment as well as the amount. More specifically, it is the type of overpayment that the contractor knows will result in unjust enrichment and yet fails to disclose. As part of the comments, it was also noted that since contractors are required by the FAR’s payment clauses to report and return overpayments of any amount, it is within the discretion of the suspension and debarment official to determine whether an overpayment is significant.



on government contractor ethics practices.<sup>16</sup> As shown in table 4, nearly all of the contractors reported using such practices.

**Table 4: Contractor Responses on Practices Now Required by the FAR for Code of Business Ethics and Conduct**

FAR standard	Contractors reporting this practice
Written code of business ethics and conduct	<ul style="list-style-type: none"><li>• 55 report having written codes</li><li>• 49 report that their codes include standards of business ethics and conduct expected of employees in their work on DOD contracts</li></ul>
Copy of the code available to employees engaged in contract performance	<ul style="list-style-type: none"><li>• 54 provide written or electronic copies of code to employees</li><li>• 51 require employee acknowledgment that they understand code</li><li>• 52 require employees to agree to uphold the ethics standards</li></ul>

Source: GAO analysis of contractor survey.

Note: At the time of our survey, contracts for the acquisition of commercial items and those that would be performed entirely outside the United States were exempt from the requirements for the code of business ethics and conduct.

Nearly All Contractors Report Having an Ethics Awareness Program, Compliance Program, or Both

One purpose of ongoing contractor ethics awareness and compliance programs can be to promote conformance with the code of business ethics and requirements. Such programs should include reasonable steps to communicate periodically to employees about the contractor’s ethics standards and procedures via training programs and communicating information on individuals’ roles and responsibilities under the ethics program. As shown in table 5, nearly all of the contractors reported including steps such as requiring ethics training and periodically communicating ethics-related information to employees working on DOD contracts.

<sup>16</sup> See The Defense Industry Initiative on Business Ethics and Conduct, *2007 Annual Public Accountability Report* (Washington, D.C., 2008); Tara A. Edwards and Frank Spasoff, “Compliance with the New FAR Ethics and Internal Control Requirements,” *Contract Management* (April 2009): 34-42; and Terrence M. O’Connor, *Federal Procurement Ethics: The Complete Legal Guide* (Vienna, Va.: Management Concepts, 2009).

**Table 5: Contractor Responses on Business Ethics and Awareness Practices for Communicating Information concerning Individual Roles and Responsibilities**

<b>FAR standard</b>	<b>Number of contractors reporting this practice</b>
<b>Have ongoing ethics awareness programs, ethics compliance programs, or both</b>	55
<b>Training required for contractors' principals and employees and, as appropriate, the contractors' subcontractors</b>	
• Principals (officers, directors, executives, etc.)	48
• Midlevel managers	51
• Permanently hired employees	50
• Short-term employees	37
• Independent contractors/consultants	12
• Employees working overseas	41
• Foreign employees	38
• Subcontractor employees	4
<b>Periodic communication mechanisms to disseminate information appropriate to individuals working on contracts on their ethics roles and responsibilities</b>	
• Orientation	54
• Staff meetings	43
• Brochures	36
• One or more other communication mechanisms (newsletter, e-mail, posters, etc.)	55

Source: GAO analysis of contractor survey.

Notes: The standards reflected in the FAR establish a framework for institutional ethics management and are displayed above in bold. As shown in the bulleted text above, because the FAR does not prescribe specific ethical requirements, our survey included multiple-choice questions about the types of (1) employees to whom contractors provided ethics training and (2) periodic communication mechanisms used.

All 41 contractors that reported having overseas contract operations indicated that they had incorporated their ethics awareness and compliance programs overseas. However 26 contractors reported experiencing challenges implementing ethics programs overseas, including differences in legal and regulatory environments relating to, for example, employee privacy, cultural and language barriers, and technical or hostile conditions impeding computer-based training.

Internal Control Systems

Having contractors implement internal control systems increases the likelihood that their ethics and compliance programs are generally effective in preventing, detecting, and addressing contract-related fraud, waste, and abuse. Nearly all of the contractors in our survey reported using internal control practices consistent with the FAR’s standards.

- High-level of management oversight. By assigning responsibility at a sufficiently high level and providing adequate staffing to ensure the effectiveness of the ethics program, a contractor can demonstrate true interest and involvement of management.<sup>17</sup> As shown in table 6, most contractors report formally assigning responsibility and staff resources to an office or individual and several have their ethics managers report on a regular basis to top management. Site visits with four contractors showed that all had ongoing and active high-level management oversight of their ethics programs.

**Table 6: Contractor Responses on Assignment of Ethics Program Responsibility and High-Level Oversight**

Practice	Number of contractors reporting this practice
Formally assign responsibility to an office or individual to implement ethics and compliance program	52
Regular reporting about business ethics awareness and compliance to these management levels	
• Chief executive officer	25 (quarterly); 7 (monthly)
• President	17 (quarterly); 4 (monthly)
• Board of directors	15 (quarterly); 0 (monthly)
• Board ethics committee, compliance committee, or both	10 (quarterly); 0 (monthly)

Source: GAO analysis of contractor survey.

Notes: The standards reflected in the FAR establish a framework for institutional ethics management. Because the FAR does not prescribe specific ethical requirements for assignment of responsibility at high levels for program responsibility or management oversight, our survey included open-ended and multiple-choice questions about the types of (1) individuals or offices responsible for the ethics and compliance program and (2) periodic reporting to various management levels. At the time of our survey, contracts for the acquisition of commercial items and those that would be performed entirely outside the United States were exempt from the internal control system requirements for management oversight. Although the FAR exempts small businesses from the internal control system requirements, nearly all contractors told us that they are not small businesses. However, if a contractor did not report assigning responsibility to implement an ethics and compliance program, we did not verify whether the company might fall under the commercial item or overseas exemptions.

<sup>17</sup> Edwards and Spasoff, 40.

- Periodic reviews and audits. An internal control system should be reviewed regularly from a compliance perspective through periodic risk assessments and audits.<sup>18</sup> Most of the contractors reported a range of practices for periodic reviews and audits, as shown in table 7. In the case of our four site visits, we confirmed that all four contractors had internal audits or reviews of their ethics program as recently as 2008. Examples of risk areas addressed by these contractors' internal ethics program audits include procurement integrity, foreign corrupt practices, and compliance with the code of conduct and policy for employee background checks.

**Table 7: Contractor Responses on Periodic Reviews and Audits**

Practice	Number of contractors reporting this practice
Internal audit or review function that audits business ethics program	52
Mechanisms to monitor effectiveness of ethics program	
• Periodic evaluation of business practices, procedures, policies, and internal controls	52
• Periodic assessments of the risk of improper or criminal conduct	47
• Program modifications in response to risk assessment to reduce risk of improper or criminal conduct	46
• Monitoring and auditing to detect improper or criminal conduct	49

Source: GAO analysis of contractor survey.

- Internal mechanism for reporting misconduct. Having and publicizing a system such as a hotline through which employees can anonymously and confidentially report or seek guidance facilitates detecting and addressing unethical and illegal activity related to contracts and helps promote a culture that encourages ethical conduct and a commitment to compliance with the law.<sup>19</sup> As shown in table 8, most of the contractors reported having such mechanisms and policies for employees to anonymously or confidentially report suspected misconduct and contract-related violations.

<sup>18</sup> Edwards and Spasoff, 41, and O'Connor, 7-10.

<sup>19</sup> United States Sentencing Commission, *Guidelines Manual*, § 8B2.1 (November 2007).

**Table 8: Contractor Responses on Anonymous/Confidential Reporting of Misconduct and Contract-Related Violations**

Practice	Number of contractors reporting this practice
Policy for employees to anonymously and/or confidentially report known or suspected conduct that violates ethics standards or contract-related requirements	54
One or more mechanisms for reporting such known or suspected conduct	55
• Hotline/helpline	54
• Ethics officers	45
• Ethics/compliance office telephone number	49
• E-mail	53

Source: GAO analysis of contractor survey.

In addition, of the 57 contractors responding to our survey, 45 reported using one or more mechanisms (for example, posters or training) to let employees know about external mechanisms for reporting contract-related misconduct, such as DOD IG's hotline, and 55 reported notifying employees of their federal whistleblower protections through one or more mechanisms, such as their ethics codes or training.<sup>20</sup>

- **Disciplinary systems.** A disciplinary system is part of providing appropriate incentives to perform in accordance with the ethics and compliance program and further demonstrates appropriate follow-through in investigating, disciplining, and correcting ethics violations.<sup>21</sup> As shown in table 9, 53 of the 57 contractors report including a disciplinary system in their ethics programs, with consequences ranging from warning to termination practices. To ensure that prompt corrective measures are carried out when violations are substantiated, 35 of the contractors

<sup>20</sup> Since January 2009, 10 U.S.C. § 2409 and 41 U.S.C. § 251 *et seq.* address protections for contractor employees who disclose information to government officials with regard to waste or mismanagement, danger to public health or safety, or violation of law related to a DOD contract or grant. Specifically, an employee may not be discharged, demoted, or otherwise discriminated against as a reprisal for disclosing to the government information concerning contract-related violations. As of January 2009, DOD regulations also require contractors to inform their employees in writing of these federal whistleblower rights and protections. DFARS Subpart 203.970.

<sup>21</sup> James C. Fontana, J. Scott Hommer III, and Peter A. Riesen, "The Brave New World of Government Contractor Compliance Programs: Maximizing Effectiveness and Minimizing Risk," *Contract Management* (January 2009): 48-59.

reported such practices as having specific offices or individuals, while 12 reported having committees, responsible for coordinating and tracking that appropriate discipline is administered. Site visits with 4 contractors confirmed that all 4 kept extensive records for management to track and oversee disciplinary actions by category of conduct violation, employee category, and business unit.

**Table 9: Contractor Responses on Ethics-Related Disciplinary Action**

Practice	Number of contractors reporting this practice
Code of ethics states that there will be disciplinary consequences for conduct that violates organization's business ethics and standards	53
Code of ethics provides examples of potential disciplinary consequences, such as warning, counseling, and employment termination	52

Source: GAO analysis of contractor survey.

Timely Disclosure

Since the FAR rule mandating timely disclosure of contractors' credible evidence of violations was not yet in effect at the time of our survey, we asked contractors about policies for voluntarily disclosing to DOD conduct in connection with defense contracts that may violate applicable requirements of law or regulation. Of the 57 contractors responding to the survey, 39 indicated that they had self-reporting policies. Of these, 34 said that their policy was to voluntarily disclose or self-report violations to government officials, such as DOD IG, contracting officers, DCMA, and DCAA. Fifteen of these contractors provided copies of their self-reporting policies. Of the 18 that indicated that they did not have self-reporting policies, 10 said it was their practice to self-report or voluntarily disclose, or to encourage the practice of self-reporting, violations to government officials. In addition, some of the contractors that had self-reporting policies reported that the types of contract-related violations subject to their self-disclosure policies and practices included

- violations of law and instances of significant employee misconduct,
- instances where there may have been overbilling caused by employee mischarging and other instances of misconduct,
- violation of the Anti-Kickback Act of 1986,
- compromise of product integrity,
- violations of federal procurement law,
- violations that added costs to the government,
- cost accounting violations, and
- suspected fraud.

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Notably, in site visits with four contractors following the November 2008 publication of the FAR's mandatory rule for timely disclosure of certain contract-connected violations, senior ethics program managers provided us information showing that all organizations were changing their voluntary disclosure policies to implement this new FAR requirement.

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## New FAR Rules May Improve DOD Oversight of Contractor Ethics Programs in Some Areas but Not Others

In response to the new FAR rules, DOD has made changes in two key areas that could improve oversight of contractor ethics programs. Specifically, DCAA revised its contract audit guidance to cover the new FAR ethics requirements. In addition, DOD IG established the new Contractor Disclosure Program to implement the new mandatory disclosure requirement. However, additional opportunities exist to improve DOD's oversight in two other key areas. For example, in a third area DOD has not assigned responsibility for verifying implementation of contractor ethics programs during contract administration. The impact of the FAR rules on oversight at this point is negligible because the authority for oversight is not explicit nor is organizational responsibility clear. In a fourth area—hotline poster displays—the new FAR rules could have the adverse consequence of reducing DOD's awareness of potential ethics violations. Under the rules, contractors have been exempted from the requirement to display DOD hotline posters if they have their own internal hotlines. This is important because if contractor employees make reports of contract-related fraud, waste, and abuse to the company hotlines instead of DOD hotlines, DOD will be less aware of potential problems. In addition, if employees use contractor hotlines instead of DOD hotlines, the employees do not receive the same protections from whistleblower laws.

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## DCAA Developed New Audit Guidance on Internal Controls for Contractor Integrity and Ethical Values

Although DCAA provides a range of services to contracting officers and other DOD officials, DCAA's primary function is contract audit services.<sup>22</sup> As part of its ongoing oversight of contractor performance during the contract administration phase, DCAA's field audit offices conduct periodic audits of contractor internal control systems. In carrying out such contract

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<sup>22</sup> To facilitate DCAA's contract audit work, under its decentralized organizational structure, DCAA has field audit offices that include resident offices at larger contractor facilities such as those included in this study.

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audits, DCAA personnel are to follow the standards, policies, and techniques prescribed in the *DCAA Contract Audit Manual* (CAM).<sup>23</sup>

Senior headquarters policy and planning managers responsible for DCAA's auditing standards indicated that the impact of the FAR contractor ethics rules on DCAA contract audits has been to improve audit guidance. To incorporate the December 2008 FAR ethics rules into its audits of contractor controls for integrity and ethical values, in July 2009 the agency distributed to its field audit offices revisions of a section of the CAM and its associated audit program.<sup>24</sup> Earlier in June 2009, when the Chief, Auditing Standards Division updated us on the status of extensive revisions then under way to improve the CAM audit guidance, she indicated that the revised guidance under development would integrate the new FAR standards into DCAA's auditing program. This was a change by DCAA since February 2009 when headquarters officials told us that they planned to make only minor changes. In their view, this was because many of the new FAR requirements were already in the DFARS section upon which the earlier audit program was based.

When we subsequently discussed preliminary findings to that effect in June 2009, the Chief, Auditing Standards Division told us that the agency had reconsidered its approach and was then proceeding to develop much more extensive audit guidance revisions than what had earlier been anticipated. In July 2009, DCAA provided us with its revised audit guidance, including the section of the CAM on controls for contractor integrity and ethical values and the associated audit program. DCAA's new guidance now integrates the FAR standards into DCAA's auditing program for identifying potential internal control deficiencies in contractors' ethics and compliance programs.

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**DOD IG Established Contractor Disclosure Program as Required by New FAR Rule**

The new FAR rule's requirement that contractors timely disclose credible evidence of certain violations of federal criminal law or violations of the civil False Claims Act made it necessary in December 2008 for DOD IG to replace its Voluntary Disclosure Program with the new Contractor

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<sup>23</sup> Defense Contract Audit Agency, *DCAA Contract Audit Manual*, DCAAM 7640.1 (Nov. 5, 2008).

<sup>24</sup> CAM 5-306—Integrity and Ethical Values, in 5-300 Section 3—Audit of Internal Controls—Control Environment and Overall Accounting System Controls.



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Disclosure Program. According to the program's manager, DOD's new contractor disclosure process provides

- contractors with Web-based and alternative means to report violations in writing;
- coordinated evaluation of criminal, civil, and administrative actions with Department of Justice (DOJ) and DOD stakeholders (including offices for the Army, Navy, and Air Force suspension and debarment authorities and buying agencies or weapon systems affected by the disclosure);
- a framework for the government to verify and, when appropriate, act on certain violations discovered through contractor self-policing; and
- centralized management combined with decentralized execution and faster turnaround of the investigative and prosecution processes.

To implement the new FAR rules, DOD took immediate steps—none of which existed under the Voluntary Disclosure Program—to direct reporting of all contractor disclosures to the Contractor Disclosure Program.<sup>25</sup> DOD IG also made early instructions available to contractors on submitting information via the Contractor Disclosure Program Web site and, in February 2009, issued a contractor's guide to submitting a disclosure.<sup>26</sup> The guide states that disclosures are made with no advance agreement regarding possible DOD resolution of the matter and with no promises from DOJ regarding potential civil or criminal actions. In the event of disclosures of potential criminal liability, however, prompt disclosure, full cooperation, complete access to necessary records, restitution, and adequate corrective actions are key indicators to DOD of an attitude of contractor integrity. DOD IG is also developing instructions—to be issued in 2009—to provide internal guidance on various DOD contractor oversight agencies' roles and responsibilities under the Contractor Disclosure Program. The instructions call on the agencies to extensively coordinate and share management of the investigation/prosecution processes.

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<sup>25</sup> For example, in December 2008 the Under Secretary of Defense for AT&L issued a memorandum to provide DOD contracting officers with guidance regarding implementing the FAR requirement for contractors' timely disclosure, in writing, to the DOD IG office of certain contract-connected violations. The Under Secretary's memorandum expressly notified DOD contracting officers of the DOD IG's designation and address for its new Contractor Disclosure Program. AT&L also initiated actions that month to incorporate this guidance in DFARS. Under Secretary of Defense (AT&L) Memorandum, DOD Implementation of the Disclosure Requirement Under FAR Clause 52.203-13 (Dec. 29, 2008).

<sup>26</sup> The DOD IG site at <http://www.dodig.mil> has Web-based disclosures and related guidance for the Contractor Disclosure Program.

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Before the new program, the DOD Voluntary Disclosure Program—administered by DOD IG since 1986—had been largely ignored by contractors for the past 10 years, according to comments received by the FAR Council from DOJ and inspectors general. The number of contractor disclosures to the Voluntary Disclosure Program fell steeply over its 22-year history, declining from about 40 to 60 voluntary disclosures accepted per year in its early years to only 9 voluntary disclosures accepted in 2008.<sup>27</sup> According to the program’s manager, in the first 7 months since the mandatory program’s start-up in December 2008, DOD has received 41 disclosures from contractors.<sup>28</sup>

DOD IG headquarters officials told us that the agency will include information on the Contractor Disclosure Program—such as the volume, nature, and disposition of active and closed disclosure cases—as part of its semiannual report to Congress.<sup>29</sup>

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### New FAR Rules Do Not Call for Verifying Implementation of Contractor Ethics Programs during Contract Administration

The FAR does not specifically require contracting officials to conduct oversight of contractors’ ethics programs during contract administration, for example, verifying that the contractor has implemented the new mandatory contractor business ethics requirement. In contrast, in certain other areas of the acquisition process the FAR provides guidance for contracting personnel regarding contractor oversight that could serve as a model for DOD to use in considering whether to step up oversight of

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<sup>27</sup> This disclosure history does not include an unknown number of matters voluntarily disclosed by contractors that DOD IG did not accept into the Voluntary Disclosure Program. For example, a disclosure would not be accepted into the program if the government had prior knowledge of the matter(s) disclosed, such as through government audit, investigation, contract administration efforts, or reports to the government by third parties. According to the Program Manager, Contractor Disclosure Program, total annual voluntary disclosures accepted by DOD IG into the program ranged as high as 59 cases in 1988 to as low as 3 cases in 2007.

<sup>28</sup> The volume of disclosures into the Contractor Disclosure Program is not strictly comparable to the volume of voluntary disclosures, according to the program’s manager. Unlike its practices under the Voluntary Disclosure Program, DOD IG accepts into the Contractor Disclosure Program all disclosures submitted from contractors. This would include accepting even disclosures of matter(s) that the government has prior knowledge of through audit, investigation, contract administration efforts, or reports by third parties.

<sup>29</sup> As required by the Inspector General Act of 1978, as amended, DOD IG reports semiannually to Congress. According to DOD IG, the semiannual report not only provides Congress and the taxpayer with a detailed account of what this organization has done during each half of each fiscal year, it is the embodiment of two important concepts upon which the agency is based—accountability and transparency.

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contractor ethics programs during contract administration. This guidance identifies several areas for which express responsibility is assigned to contracting officials for verifying contractor compliance with applicable laws and regulations. These areas include activities related to environmental practices and a drug-free workplace. In addition, guidance is provided to contracting personnel regarding, as applicable, quality assurance and safety, both of which are cited in the FAR as general standards for determining whether a prospective contractor is responsible, just as having a satisfactory record of integrity and business ethics is a responsibility standard.<sup>30</sup> Such oversight during contract formation and administration is done, in part, to avoid any adverse impacts on contract performance or cost after contract award.

As DOD's lead contract administration agency, DCMA provides a range of services to contracting officers and other DOD officials after contract award.<sup>31</sup> If assigned to do so by a contracting officer as part of DCMA's contract administration responsibilities after contract award, DCMA monitors contractor performance and management systems to ensure that cost, quality, and schedule are in compliance with the terms and conditions of the contracts.<sup>32</sup> DCMA's monitoring is primarily performed by an administrative contracting officer (ACO) located in the field at a contract administration office (CAO) who is assigned to administer the

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<sup>30</sup> FAR subpart 9.1.

<sup>31</sup> As of December 2008, DCMA reports managing 291,000 prime contracts valued at \$950 billion. However, according to DCMA headquarters officials, most contracts DCMA manages pertain to major weapon system procurements. Not generally covered by DCMA's contract management services are most of DOD's services contractors, other than those on a limited number of services contracts related to DOD weapon systems maintenance and the Army's Logistics Civil Augmentation Program contract to support worldwide contingency operations.

<sup>32</sup> After contract award, the procuring contracting officer at the buying office may or may not assign contract administration (i.e., oversight) responsibility to a separate office. If the contracting officer does not assign this responsibility to a separate office, contract administration remains the contracting officer's responsibility. Under the FAR, when a contract is assigned for administration, the contracting officer normally delegates portions of a list of 70 specific contract administration functions to a designated contract administration office (CAO). FAR Subpart 42.3—Contract Administration Office Functions. Under DFARS, some additional CAO functions are identified for the review and evaluation of certain other contractor cost estimating and accounting systems. DFARS Subpart 242.3—Contract Administration Office Functions.

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contract with assistance from engineers and other specialists at DCMA.<sup>33</sup> To specifically combat procurement fraud with a strong focus on assisting CAOs through coordination of remedies and process improvement, DCMA also has a Contract Integrity Center—operated by its Office of General Counsel—with attorneys geographically dispersed across the United States. According to DCMA, these contracting integrity attorneys work full-time on the prevention, detection, investigation, and prosecution of allegations of procurement fraud and other misconduct.

Despite DCMA having the important role of performing contract administration services for many of DOD's contracts after award, the impact of the new FAR rules on changing the CAO function to include some degree of oversight to verify implementation of contractor ethics programs has been negligible. For example, most of the nine CAO staff we talked to who provide ongoing contract administration and oversight of seven major DOD contractors told us that they may receive information from the contractors or from DCAA on the status of contractors' ethics programs. In addition, they monitor contractor ethics program actions to correct internal control deficiencies for integrity and ethical values in response to deficiencies discovered during DCAA audits. However, other than reacting as information comes to them from the contractor and DCAA, the CAO staff indicated that they were not planning to routinely verify contractor ethics program efforts. Some of these staff indicated that they were willing to monitor contractors' ethics programs but noted that it is currently not required by the FAR. Some staff indicated that if such a task was required, criteria or instructions on what to look for would be needed. However, the new FAR rules are silent with regard to contracting officer review or standards for examining contractor ethics programs during contract administration. As such, without further guidance, CAO staff will continue as before the new FAR rules were implemented with limited oversight of contractors' ethics programs.

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<sup>33</sup> On a given contract, there may be two types of contracting officers: (1) the procuring contracting officer at the buying office, who awards and signs the contract, and (2) if assigned by the procuring contracting officer after contract award, the ACO at the CAO who administers the contract, which includes monitoring contractor performance. To facilitate its contract administration work, under its decentralized organizational structure, DCMA's divisions have 47 field CAOs and assign "corporate" administrative contracting officers to provide oversight at larger contractor facilities, such as those included in this study. As of December 2008, DCMA has about 10,000 civilian and military staff overseeing almost 19,000 contractors.

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Before the FAR requirements were finalized in 2008—and Congress mandated that we report on the extent to which DOD monitors or approves defense contractors’ ethics programs—we previously recommended in 2005 that DOD needs to obtain more knowledge of contractors’ standards of conduct efforts and that enhanced awareness of contractor ethics programs would enable DOD to assess whether the public trust is protected.<sup>34</sup> We recommended that DOD take actions to improve its knowledge and oversight of contractors’ ethics programs. DOD commented that the recommendation was currently implemented when contracting officers make, prior to awarding a contract, an affirmative determination of responsibility, which included consideration of the potential contractor’s business practices and the potential contractor’s integrity. As we then indicated in response to DOD’s comment, more could be done through assessments of contractor ethics programs to enhance contracting officers’ ability to make such determinations.

Four years later, with the FAR rules having been significantly expanded, DOD has not determined what if any changes are needed to its oversight of contractor ethics programs during contract administration. The FAR Council disposition in 2007 of public comments received from the initial FAR rulemaking process provides some insight into what contractors might expect of contracting officials’ oversight of the new ethics program requirements. For example, the FAR Council commented that review of contractors’ compliance would be incorporated into normal contract administration on a discretionary basis, but provided no description on how responsibility for that discretionary duty would be assigned or exercised.<sup>35</sup> If such a review were to be required by DOD guidance, it could use the FAR’s framework for contractor ethics program standards to begin to provide a basis for DCMA or other contracting officials to verify that a contractor has established the type of internal ethics and compliance program to be expected. This, in turn, would provide some assurance that contractors are following ethics programs as expected by the FAR Council to help prevent, detect, and timely disclose contract-related fraud, waste, and abuse.

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<sup>34</sup> [GAO-05-341](#).

<sup>35</sup> As part of the rulemaking process, several respondents questioned how the contracting officer would verify compliance with the requirements. The FAR Council commented that the contracting officer is not required to verify compliance, but may inquire at his or her discretion as part of contract administrative duties. 72 Fed. Reg. 65878 (Nov. 23, 2007).

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Beyond the issue of authority, there is no consensus among DOD contractor oversight officials on where organizationally such responsibility for verifying the implementation of the new FAR ethics program requirements during contract administration would be assigned. Some of DCMA's CAO staff that we spoke with at several of DOD's largest contractor facilities said that oversight of contractor ethics program compliance would fit into their contract administration area of responsibility. Other contractor oversight officials at DOD IG, DCAA, and the Office for the Under Secretary of Defense for AT&L told us that verifying or monitoring DOD contractor ethics programs would logically fit with DCMA's contract administration services.

DCMA headquarters officials, however, stated that it is not their agency's functional responsibility to verify compliance with the new contractor ethics requirements. One senior DCMA headquarters official indicated that it would be better to assign responsibility for this function to DCAA's contract audit services that assess the adequacy of contractor internal controls for integrity and ethical values.<sup>36</sup> In addition, assigning this function to DCMA alone would leave some defense contractors unaddressed because DCMA is not delegated management responsibility for all defense contracts, according to its headquarters officials.<sup>37</sup> Rather, CAO staff at DCMA's field locations oversee just those contracts and perform contract administration as assigned to them by procuring contracting officers at DOD's buying offices. Thus, for many of DOD's contractors, the contract administration function is retained by the procuring contracting officer. As a result, other contracting officials across DOD procuring offices would need to examine any contractors not covered by DCMA CAO staff.

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<sup>36</sup> Under the FAR, however, DCAA's role is advisory, which means it has less authority than DCMA's CAOs have to require contractor action to correct deficiencies DCMA identifies through contract administration.

<sup>37</sup> According to DCMA headquarters' officials, DCMA's contract administrative functions do not address most of DOD's services contractors.

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Not Requiring Display of  
DOD Hotline Posters  
Could Delay or Lessen  
DOD's Awareness of  
Problems and Use of  
Whistleblower Protections

Under the FAR rule effective in December 2007, defense contractors are not required to display DOD IG's fraud hotline posters if the contractors' ethics and compliance programs include reporting mechanisms such as their own hotline posters.<sup>38</sup> According to a FAR Council response to public comments in finalizing the agency hotline display rule in 2007, the exemption was to mirror earlier DFARS guidance, which permitted contractors to post their own hotline posters, in lieu of DOD hotline posters, to provide an outlet for employees to raise issues of concern.<sup>39</sup> This exemption has two potential adverse consequences for DOD oversight of defense contractors: lessening DOD's awareness of problems and diminishing contractor employee awareness of whistleblower protections.

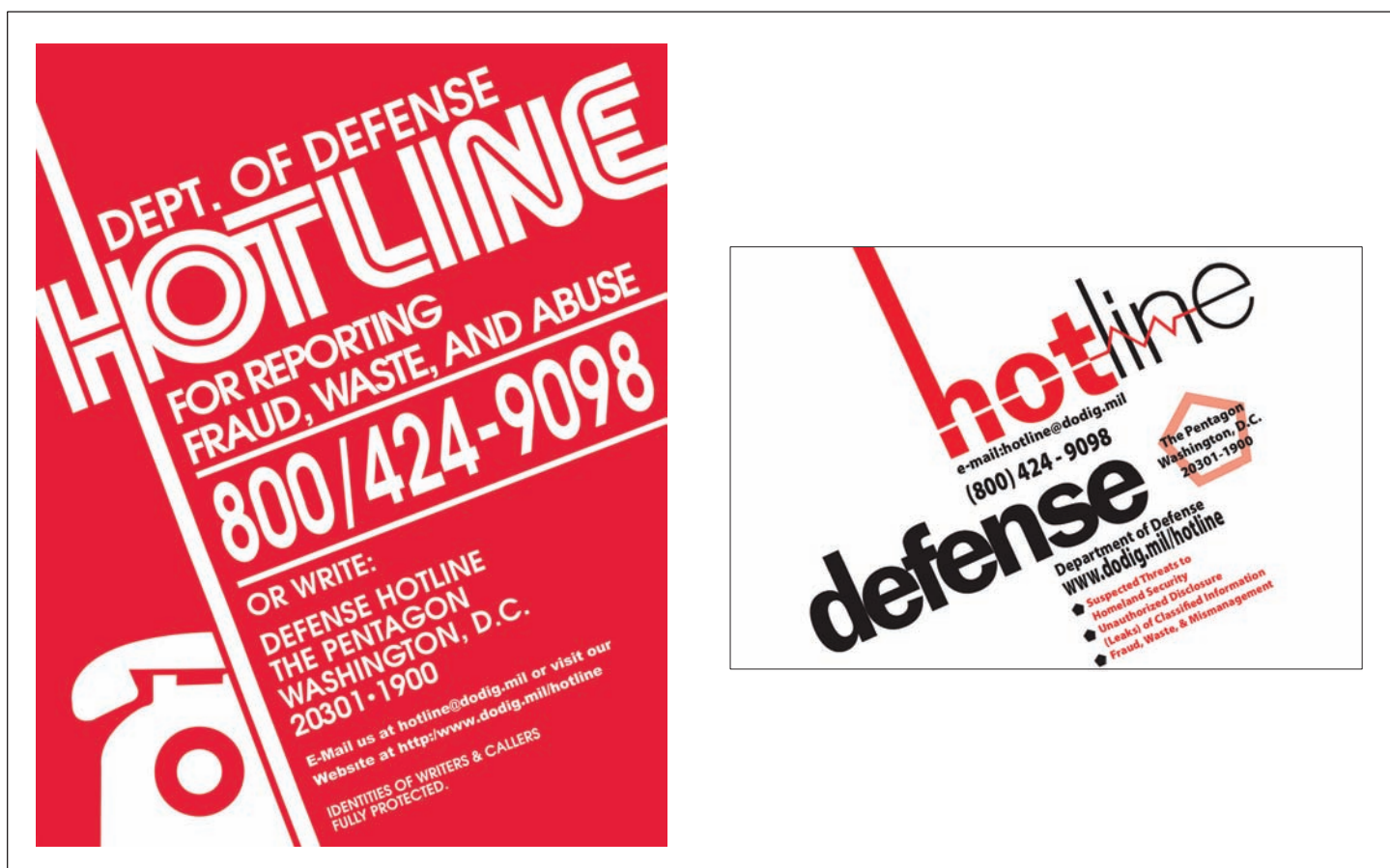
The display of the standard hotline posters available to contractors from DOD IG, shown in figure 1, at contractor work sites is part of DOD's efforts to fight procurement and other types of fraud, waste, and abuse.

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<sup>38</sup> Under FAR 52.203-14—Display of Hotline Poster(s), a contractor is exempt from the required display of DOD IG's fraud hotline poster if the contractor has an ethics and compliance program that includes a reporting mechanism such as a hotline poster. According to the FAR Council, unless an agency's inspector general requires specific requirements and information for posters, there is no need to have multiple agency posters if a company has its own internal reporting mechanism.

<sup>39</sup> DFARS Subpart 203.70—Contractor Standards of Conduct, guidance removed by DOD on August 12, 2008. 73 Fed. Reg. 46815 (Aug. 12, 2008).

Figure 1: DOD Hotline Posters Available for Contractor Display



Source: DOD IG.

In fiscal year 2008 alone, DOD's hotline received nearly 14,000 contacts resulting in 2,000 cases referred for investigation. However, because the FAR rule exempts contractors whose ethics programs include their own hotlines, and if more contractors opt not to display DOD's hotline posters, there is a risk that defense contractor employees will be unaware and not avail themselves of DOD's hotline. According to our ethics program survey, 55 of the 57 contractors report having one or more reporting mechanisms, such as a hotline for employees to report known or suspected conduct that violates ethics standards or contract requirements.

The DOD hotline poster's absence from contractor work sites could also jeopardize use of whistleblower protections for contractor employees put



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in place by DOD in response to legislation separate from the development of the FAR's contractor ethics program requirements.<sup>40</sup> Under this legislation, federal protections were strengthened for contractor employees against employer reprisals for blowing the whistle to government entities (such as DOD IG through its fraud hotline) on suspected gross mismanagement of or illegal activities on a DOD contract. The contractor internal reporting mechanisms, such as hotline posters required separately under the new FAR rules, do not provide contractor employees with the type of whistleblower protections that disclosure to DOD IG or to other DOD entities offers.<sup>41</sup>

Although DFARS, since January 2009, requires contractors to inform their employees in writing of these federal whistleblower rights and protections,<sup>42</sup> without display of DOD's hotline poster in a contractor work site, contractor employees could unwittingly disclose information to the company's internal hotline, where they would not have federal protections in the event of employer reprisals. To facilitate contractor employee whistleblower protections, senior DOD IG headquarters officials responsible for investigations and policy agreed that it might be necessary to modify DOD hotline posters for display at contractor work sites to inform contractor employees that their federal whistleblower protections are limited to disclosures to government entities only.

According to FAR Council responses to public comments received while finalizing the hotline display rule, it is the responsibility of the agency inspector general to determine the need for, and the contents of, the fraud hotline poster. Given the magnitude of DOD's contract dollars spent each year, with tens of thousands of contractors and ongoing efforts by DOD through its Panel on Contracting Integrity to reduce vulnerabilities to procurement fraud, we asked DOD IG, DCAA, suspension and debarment,

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<sup>40</sup> Duncan Hunter National Defense Authorization Act for Fiscal Year 2009, Pub. L. No. 110-417 § 842 (2008).

<sup>41</sup> Under DOD IG hotline policy, to reduce fear of potential employer reprisal and encourage hotline disclosures, the identity of contractor employees who report through the DOD hotline is not released without employee permission. DOD IG Mission Briefing (Feb. 24, 2009).

<sup>42</sup> DFARS Subpart 203.9.

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and AT&L contractor oversight officials for their views.<sup>43</sup> Specifically, we asked about the risk of defense contractors not displaying DOD hotline posters and whether the hotline poster's absence in workplaces where DOD contracts are performed might impinge on DOD's ability to timely address contractor violations. Several of the DOD oversight officials were not aware of the FAR's exemption regarding display of the DOD hotline posters until we told them.

Once informed, some of these DOD officials expressed concern that the hotline poster's absence was not in the best interest of reducing DOD's vulnerability to procurement fraud. DOD IG officials agreed that changing DFARS to require all defense contractors to display the DOD hotline poster should occur. Nearly all of the 57 contractors we surveyed appear positioned to detect problems because they report having mechanisms such as hotlines for employees to report problems. However, the DOD IG team leader for military reprisal investigations expressed concern that contractor employees may be uncomfortable reporting to their companies' internal hotlines, an indication that relying only on contractor reporting mechanisms could also result in DOD not finding out about the problems at all. Moreover, relying on contractor mechanisms could also delay DOD's awareness of such problems and its efforts to verify and act on suspected violations. For example, under the new FAR rules, the length of time it takes a contractor to determine if there is credible evidence of a violation subject to mandatory disclosure requirements could affect DOD's awareness of a problem.<sup>44</sup> With the DOD hotline, DOD has immediate awareness of potential violations from contractor employee calls. While there might be practical reasons for continuing to exempt some defense contractors with their own hotlines from displaying DOD's hotline poster,

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<sup>43</sup> In February 2007, the Under Secretary of Defense for AT&L established the Panel on Contracting Integrity, as required by section 813 of the Defense Authorization Act for Fiscal Year 2007. The panel, whose executive director is the Director, Defense Procurement and Acquisition Policy and Strategic Sourcing, includes more than 20 senior-level procurement executives, inspectors general, and other representatives from across DOD. As required by the act, DOD has submitted two annual reports to Congress since December 2007 on the panel's findings and recommendations to foster and monitor contracting integrity across the department. John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364 § 813 (2006).

<sup>44</sup> Subsequent to detecting problems through such internal hotlines, in accordance with the new FAR rules, contractors are to determine whether there is credible evidence that certain contract-related violations have occurred. If the contractor determines there is credible evidence, the FAR then requires the contractor's timely disclosure of violations to the agency inspector general. FAR 52.203-13.

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such as avoiding the confusion or duplication that could occur with too many hotline posters on display in one place, senior contract policy officials in the Office of the Under Secretary of Defense for AT&L believe that further study is warranted of possible changes in DFARS to more fully protect defense contracting integrity.<sup>45</sup>

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## Conclusions

The FAR requirements provide new direction for defense contractor ethics programs and present DOD opportunities to improve its oversight of these programs. The new rules seek to promote organizational cultures that encourage ethical behavior as well as promote compliance with the law. Our survey completed in 2009 shows that nearly all of the 57 major defense contractors reviewed included many of the ethics program practices before the FAR rules were finalized consistent with the standards later required for compliance. DOD, in turn, is making positive changes to address some of the new FAR requirements.

However, additional opportunities exist to improve DOD's oversight in two key areas. The first is in the area of verifying the existence of contractor ethics programs after contract award as part of contracting officers' contract administration responsibility. The need for new oversight attention and guidance across DOD in the area of contract administration has not been clearly identified or determined. Such additional oversight of contractor ethics programs during contract administration could help ensure that contractor ethics programs are in place as intended.

The second is in the area of DOD's hotline program, for improved oversight for potential contract-related fraud, waste, and abuse. The new FAR contractor ethics rules have the potential to make the hotline program less effective by ultimately reducing contractor exposure to DOD hotline posters and diminishing the means by which fraud, waste, and abuse can be reported under the protection of federal whistleblower laws. Nearly all of the major contractors surveyed have in-house ethics and compliance programs that exempt them from displaying the DOD posters. It is conceivable that virtually no major contractor would be required to display the DOD hotline posters. Contractor employees might be reluctant

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<sup>45</sup> According to senior contract policy officials in the Office of the Under Secretary of Defense for AT&L, DOD's Panel on Contracting Integrity could take up consideration of this and related matters concerning DOD contracting oversight that are affected by FAR changes requiring contractor ethics programs.

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to report violations to an in-house hotline that did not provide federal protection against company retaliation. However, employees do have such protection when reporting directly to the DOD hotline.

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## Recommendations for Executive Action

We are recommending four actions aimed at improving DOD's oversight of defense contractors' ethics programs. First, to strengthen oversight during contract administration, we recommend that the Secretary of Defense direct the Under Secretary of Defense for AT&L to determine what if any new DFARS or other guidance is needed to clarify functional responsibilities of DCMA and other contracting officials during contract administration for verifying the implementation of contractor ethics programs as required under the FAR ethics rules.

To avoid delaying or lessening DOD IG awareness of contract-related problems and diminishing of whistleblower protections for contractor employees, we recommend that the Inspector General for the Department of Defense, in accordance with the FAR, take the following two actions:

- Determine the need for defense contractors' display of DOD IG's fraud hotline poster, including directing a contractor to display the DOD IG hotline poster in common work areas for performance of DOD contracts.
- Determine the contents of the DOD IG's fraud hotline poster for display by defense contractors, including revising the poster to inform contractor employees of their federal whistleblower protections.

Fourth, if the need for hotline poster display is determined by the Inspector General, we recommend that the Secretary of Defense direct the Under Secretary of Defense for AT&L to propose revisions to DFARS to include policy requiring a contract clause directing a contractor to display the DOD IG hotline poster in common work areas for performance of DOD contracts. DFARS policy should require a defense contractor's display of the DOD IG fraud hotline poster irrespective of whether that contractor has its own internal mechanism, such as a hotline for employees to report contract-related improprieties.

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## Agency Comments

We provided a draft of this report and the e-supplement that accompanies it to DOD for comment.<sup>46</sup> The Office of the Under Secretary of Defense for

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<sup>46</sup> The e-supplement, which presents results from the survey of contractor ethics programs, can be found on our Web site at <http://redesign-www.gao.gov/special/pubs/gao-09-646sp/index.html>.

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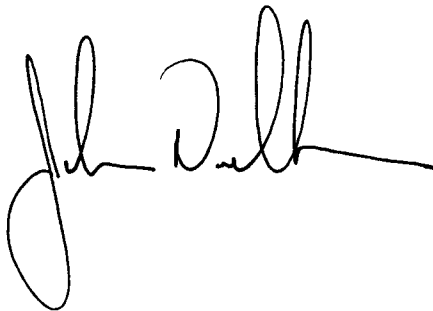
AT&L's Director, Defense Procurement and Acquisition Policy, wrote that DOD concurs with the first three recommendations. For example, according to the Director, the first recommendation will be referred to the Defense Acquisition Regulation (DAR) Council to establish a DFARS case to determine whether additional guidance is needed to clarify the administrative contracting officer's functional responsibilities.

Regarding the last recommendation, the Director wrote that DOD partially concurs because it is not necessary (as we recommended) for the Panel on Contracting Integrity to propose the revisions. However, in response to this recommendation, the Director will submit the proposed revisions to DFARS via memorandum to the DAR Council. Since DOD's comment concurs with the substance of the recommendation, we revised it to better align with DOD's preferred method for implementation. DOD's comments are reprinted in appendix II.

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We are sending copies of this report to the Secretary of Defense, the DOD Inspector General, the Director of the Office of Management and Budget, the major defense contractors identified in this report, and other interested parties. The report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-4841 or [needhamjk1@gao.gov](mailto:needhamjk1@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

A handwritten signature in black ink, appearing to read 'John K. Needham', with a stylized, flowing script.

John K. Needham  
Director, Acquisition and Sourcing Management

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*List of Congressional Committees*

The Honorable Carl Levin  
Chairman  
The Honorable John McCain  
Ranking Member  
Committee on Armed Services  
United States Senate

The Honorable Ike Skelton  
Chairman  
The Honorable Howard P. “Buck” McKeon  
Ranking Member  
Committee on Armed Services  
House of Representatives

# Appendix I: Scope and Methodology

Congress included a provision in the National Defense Authorization Act for Fiscal Year 2008 requiring us to report on the internal ethics programs of major defense contractors.<sup>1</sup> In January 2009, we briefed the Senate and House Armed Services Committees on the preliminary results regarding the reporting requirements specified in the act. After this congressional mandate, revisions to the Federal Acquisition Regulation (FAR) to require internal ethics programs of contractors were finalized. As shown in table 10's side-by-side comparison, ethics program elements identified by Congress for inclusion in this report are very similar to the contractor ethics program elements now required by the FAR.

**Table 10: Comparison of Ethics Program Elements in Congressional Mandate and FAR Requirements**

Contractor internal ethics program elements	Congressional mandate	FAR requirements
Written code of business ethics and conduct		X
Internal mechanisms, such as hotlines, for reporting misconduct	X	X
Notification to employees of external mechanisms, such as the Department of Defense (DOD) Inspector General (IG) hotline, for reporting misconduct	X	X
Notification to employees of their right to be free from reprisal for disclosing a substantial violation of law related to a contract	X	<sup>a</sup>
Ethics training programs	X	X
Internal audit or review programs	X	X
Requirements for self-reporting violations to government officials	X	X
Disciplinary action	X	X
Appropriate management oversight	X	X

Sources: Section 848 of the National Defense Authorization Act for Fiscal Year 2008 and FAR Subparts 3.10, Clauses 52.203-13, and 52.203-14 (information); GAO (analysis and presentation).

<sup>a</sup>We also reported on contractor employee whistleblower protections, which were addressed in § 846 (b)(2)(C) of the National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181, and § 842 (a) of the National Defense Authorization Act for Fiscal Year 2009, Pub. L. No. 110-417 (2008).

Given the similarity between some of the ethics program elements in our congressional mandate and the current FAR requirements, our audit and reporting objectives were to (1) describe the extent to which contractors

<sup>1</sup> Section 848(a) required us to report by January 28, 2009, on the internal ethics programs of major defense contractors. Pub. L. No. 110-181 § 848 (2008).

had ethics programs before the finalization of the FAR rules that included practices consistent with standards now required by the FAR and (2) assess the impact the new FAR rules have on DOD oversight of contractor ethics programs.

Section 848 defined a major defense contractor as any company awarded contracts by DOD during fiscal year 2006 in amounts totaling more than \$500 million. To identify those contractors, we analyzed data on the values of contracts awarded to all companies from DOD's Statistical Information Analysis Division. We initially identified 65 contractors, but we eliminated six companies that merged or were joint ventures, as well as two foreign government entities from our review. Based on our review of DOD's data, we found that the data were sufficiently reliable for the purpose of identifying which contractors to include in this report. As a result, we identified the 57 contractors meeting the major defense contractor criteria to include in our review. As shown in table 11, which ranks the 57 major defense contractors by the value of their fiscal year 2006 DOD contract awards, these companies accounted for more than half of DOD's total contract awards in 2006—\$164.5 billion of the total \$295 billion.

**Table 11: Contractors Reviewed by GAO, by Value of Total Contract Awards from DOD in Fiscal Year 2006**

Dollars in millions			
Contractor	Value of DOD contract awards	Contractor	Value of DOD contract awards
Lockheed Martin Corporation	\$26,620	Shell Oil Company	\$1,151
Boeing Company	21,721	Alliant Techsystems, Inc.	1,128
Northrop Grumman Corporation	16,627	Oshkosh Truck Company	941
General Dynamics Corporation	11,942	Rockwell Collins, Inc.	824
Raytheon Company	10,069	Korea Agricultural Cooperative	761
BAE Systems PLC	6,192	DRS Technologies	730
KBR, Inc.	6,060	Phillips & Jordan, Inc.	705
L-3 Communications Holding, Inc.	5,197	CACI International, Inc.	681
United Technologies Corporation	4,453	General Atomic Technologies Company	670



## Appendix I: Scope and Methodology

Dollars in millions

Contractor	Value of DOD contract awards	Contractor	Value of DOD contract awards
Science Applications International Corporation (SAIC)	3,211	McKesson Corporation	670
Computer Sciences Corporation (CSC)	2,884	Valero Energy Corporation	661
Humana, Inc.	2,642	Thales	657
ITT Corporation	2,522	Aerospace Corporation	654
General Electric Company	2,328	Mitre Corporation	652
Health Net, Inc.	2,119	Massachusetts Institute of Technology	640
Triwest Healthcare Alliance Company	2,022	Dell, Inc.	636
Electronic Data Systems Corporation	2,008	Cardinal Health, Inc.	635
AM General, LLC	1,944	Syracuse Research Corporation	613
Agility Logistics	1,838	Chugach Alaska Corporation	593
Honeywell International, Inc.	1,679	Refinery Associates of Texas	577
Textron, Inc.	1,369	Environmental Chemical Corporation	570
URS Corporation	1,369	Parsons Corporation	526
Amerisourcebergen Corporation	1,346	Johns Hopkins University	525
Harris Corporation	1,339	Battelle Memorial Institute	519
FedEx Corporation	1,303	Shaw Group, Inc.	519
Bechtel Group, Inc.	1,264	Maersk Line Ltd.	516
Booz Allen Hamilton, Inc.	1,245	Jacobs Engineering Group, Inc.	505
BP America, Inc.	1,199	Kraft Foods, Inc.	501
Exxon Mobil Corporation	1,176		
<b>Total DOD contract awards to these 57 contractors in 2006</b>			<b>\$164,448</b>
<b>Total DOD contract awards to all contractors in 2006</b>			<b>\$294,976</b>

Sources: GAO (analysis); DOD (data).

Note: The dollar value of DOD contract awards in 2006 for each contractor was rounded to the nearest million.

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We conducted this performance audit from May 2008 through August 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The scope and methods we used to perform this audit are described in greater detail in the remainder of this appendix.<sup>2</sup>

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## First Audit Objective

To determine the extent to which 57 major defense contractors included in our review have internal ethics programs that include certain practices consistent with standards now required by the FAR, we designed and conducted a Web-based survey of all 57 contractors. To gain an initial understanding of the variety and scope of information reasonably available on the range of practices used in relation to internal ethics programs, we reviewed chapter 8 (Sentencing of Organizations) of the *2007 Federal Sentencing Guidelines Manual* and government contract management publications for information to describe the FAR contractor ethics program requirements. We also interviewed officials from government and public entities with knowledge in this area, including the Defense Industry Initiative on Business Ethics and Conduct, the Ethics Resource Center, DOD, and the Department of Justice's National Procurement Fraud Task Force.

To conduct this survey, we pretested it in July 2008 with Lockheed Martin Corporation, Electronic Data Systems Corporation, Agility Logistics, and Mitre Corporation to determine if the questions were clear and unbiased, if the terminology used to describe the programs was precise, and whether the survey questionnaire placed an undue response burden on companies. After revising the survey to incorporate pretest comments in August 2008, we sent an e-mail to all 57 contractors in early September 2008 with instructions for accessing the survey and followed up with

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<sup>2</sup> The scope of our review limits our analysis as follows: (1) we limited this review to 57 major defense contractors and thus our results cannot be generalized as representing all defense contractors' internal ethics programs and (2) we limited our review to self-reported responses and corroborating documentation from contractors on their internal ethics programs, which we did not independently verify for implementation or test for effectiveness.

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nonrespondents by e-mail and telephone to encourage their responses. After we closed out the survey on October 24, 2008, congressional committee staff requested that we pursue responses from the remaining unresponsive contractors, and we contacted the contractors; reopened the survey on March 13, 2009, for 5 business days; and obtained their responses.

The multisection survey was designed to address all of the ethics program elements identified in Section 848 and those now required by the FAR, as shown in table 10's side-by-side comparison. The survey was organized in various sections to obtain contractors' self-reported information on their internal ethics programs in key areas, such as (1) code of business ethics and conduct, (2) internal and external mechanisms for reporting misconduct, (3) notification to contractor employees of their right to be free from reprisal for disclosing a substantial violation of law, (4) ethics training programs, (5) internal audits, and (6) appropriate management oversight. GAO's e-supplement, [GAO-09-646SP](#), provides the questions used for the survey as well as the aggregated responses. We analyzed responses from the 57 contractors that responded to the survey—a survey response rate of 100 percent—in comparison to the FAR requirements introduced from December 2007 through December 2008. In addition to analyzing self-reported information from the survey responses, we requested that all 57 contractors send us corroborating documentation to review for various practices in their internal ethics programs, including practices now required by the FAR, such as management oversight and ethics and compliance training. We did not verify implementation or test the effectiveness of contractor ethics program practices self-reported through our survey.

We selected a nongeneralizable sample of 4 of the 57 contractors for site visits in order to review in detail implementation practices for some of the ethics program policies or procedures described in their survey responses, such as disciplinary actions, hotline calls, and ethics training programs. Our selection criteria in part were whether (1) the contractors were ranked among the top 15 contractors in terms of dollar value of DOD contracts awarded to them in fiscal year 2006 and (2) their survey responses indicated that the contractors had such policies or procedures in use. We visited Boeing Company, General Dynamics, Computer Sciences Corporation (CSC), and Science Applications International Corporation (SAIC) from December 2008 through February 2009 and obtained detailed information from senior company officials responsible for management of ethics program-related practices described in their responses to our survey.

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To determine the benefits and challenges contractors face in implementing the new FAR requirements, we analyzed contractor views from our Web-based survey. To identify views and perspectives similar to or different from those obtained from the survey, we reviewed responses to public comments prepared by the FAR Council and published in the *Federal Register*.

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## Second Audit Objective

To assess the impact that expanded FAR contractor ethics program requirements have on DOD monitoring or approval of defense contractor ethics programs, we focused on defense and military organizations responsible for oversight and investigation of contractor operations and improper business practices: (1) Defense Contract Management Agency (DCMA); (2) Defense Contract Audit Agency (DCAA); (3) DOD IG; (4) the Air Force, Army, and Navy offices responsible for suspension and debarment; and (5) the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L). We interviewed senior procurement officials; general counsel; and contract administration, audit, and investigative service officials concerning these agencies' roles and responsibilities for monitoring or approving contractor ethics programs. Through interviews and information obtained from these officials, we obtained views and reviewed supporting documentation concerning the impact the new FAR rules have had or could have on DOD contractor oversight activities regarding monitoring contractors' compliance with ethics program practices required by the FAR rules.

In addition, we communicated with selected officials from the DOD agencies listed above to obtain updates regarding changes in their policies and procedures to implement the expanded FAR requirements, reviewed available guidance and instructions these agencies developed to implement the FAR changes, and analyzed public comments attributed to DOD or other government sources and FAR Council responses published in the *Federal Register* relevant to agencies' implementation of the requirements. We also interviewed senior DCAA and DCMA officials colocated at four contractor field office locations to discuss their oversight of contractor ethics programs and any concerns they might have related to those programs on contractor performance and costs. We did not test DOD agencies' effectiveness in implementing their contractor ethics program oversight activities.

# Appendix II: Comments from the Department of Defense



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

SEP 16 2009

Mr. John K. Needham  
Director, Acquisition and Sourcing Management  
U.S. Government Accountability Office  
441 G Street, N.W.  
Washington, DC 20548

Dear Mr. Needham:

This is the Department of Defense (DoD) response to the GAO Draft Report, GAO-09-591, "DOD CONTRACTING INTEGRITY: Opportunities Exist to Improve DoD's Oversight of Contractor Ethics Programs," dated August 21, 2009 (GAO Code 120736).

The Department comments on the report recommendations are enclosed.

Sincerely,

A handwritten signature in black ink, appearing to read "Shay D. Assad", is located below the "Sincerely," text.

Shay D. Assad  
Director, Defense Procurement  
and Acquisition Policy

Enclosure:  
As stated

GAO DRAFT REPORT - DATED AUGUST 21, 2009  
GAO-09-591 (GAO CODE 120736)

**“DOD CONTRACTING INTEGRITY: OPPORTUNITIES EXIST  
TO IMPROVE DOD’S OVERSIGHT OF CONTRACTOR’S  
ETHICS PROGRAMS”**

**DEPARTMENT OF DEFENSE COMMENT  
TO THE GAO RECOMMENDATION**

**RECOMMENDATION 1:** The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Acquisition, Technology and Logistics) to determine what if any new Defense Federal Acquisition Regulation Supplement (DFARS) or other guidance is needed to clarify functional responsibilities of Defense Contract Management Agency (DCMA) and other contracting officials during contract administration for verifying the implementation of contractor ethics programs as required under the Federal Acquisition Regulation (FAR) ethics rules.

**DOD RESPONSE:** Concur. The recommendation will be referred to the Defense Acquisition Regulation Council to establish a DFARS case to determine whether additional guidance is needed to clarify the functional responsibilities of the administrative contracting officer.

**RECOMMENDATION 2:** The GAO recommends that the DoD Inspector General (DoD IG), in accordance with FAR, determine the need for defense contractors’ display of the IG’s fraud hotline poster to include directing a contractor to display the DoD IG hotline poster in common work areas for performance of DoD contract.

**DOD RESPONSE:** Concur.

**RECOMMENDATION 3:** The GAO recommends that the DoD IG, in accordance with FAR, determine the contents of the IG’s fraud hotline poster for display by defense contractors to include revising the poster to inform contractor employees of their federal whistleblower protections.

**DOD RESPONSE:** Concur.

**RECOMMENDATION 4:** The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Acquisition, Technology and Logistics) to task the DoD Panel on Contracting Integrity draft proposed revisions to the DFARS to include policy requiring a contract clause directing a contractor to display the DoD IG hotline poster in

common work areas for performance of DoD contracts. DFARS policy should require a defense contractor's display of the DoD IG fraud hotline poster irrespective of whether that contractor has its own internal mechanism such as a hotline for employees to report contract-related improprieties.

**DOD RESPONSE:** Partially concur. The FAR clause 52.203-14 already requires the contractor to prominently display the DoD Hotline Poster in common work areas within business segments performing work under the contract and at contract work sites with the exception noted at paragraph (c). The issue is the exception noted at 52.203-14(c) which states that if the contractor has implemented its own business ethics and conduct awareness program including a reporting mechanism, the agency fraud hotline poster need not be displayed. DPAP will submit the proposed revision to DFARS in a memorandum to the Director, DAR Council, identifying this GAO recommendation. It is not necessary for the Panel on Contracting Integrity to propose revisions. The DFARS team working this policy area will consider the GAO recommendations.

# Appendix III: Required Federal Acquisition Regulation Components for Contractor Ethics Programs

The final FAR rule—effective in December 2008—reflects contractor ethics program standards across four broad components, as shown in table 12.<sup>1</sup> According to the FAR Council, the rule establishes a framework for institutional ethics management and disclosure but does not prescribe specific ethical requirements. Contractors are free to establish the appropriate ethical standards for their businesses.

**Table 12: Required FAR Components for Contractor Ethics Program Practices**

Component requirement	Description
<b>Code of business ethics and conduct</b>	Required for businesses with contracts or subcontracts over \$5 million and a period of performance of 120 days or more; must be implemented within 30 days of contract award; must be written and distributed to all employees.
<b>Ethics awareness and compliance program</b>	Required for noncommercial item acquisitions and businesses that are other than “small” and with contracts or subcontracts over \$5 million and a period of performance of 120 days or more; must be implemented within 90 days of contract award. The ongoing program shall include steps to periodically communicate the contractor’s business ethics standards and procedures by conducting training programs for all employees.
<b>Internal control system</b> —Required for noncommercial item acquisitions and businesses that are other than “small” and with contracts or subcontracts over \$5 million and a period of performance of 120 days or more. Among others, minimum practices required for the contractor’s internal control system include the following.	
High level of management oversight	Assignment of high-level responsibility within the organization and adequate resources for the ethics and compliance program.
Periodic reviews, audits, or both	Required to evaluate effectiveness of company business practices, procedures, and policies, and internal controls for compliance with the established code of business ethics and conduct and the special requirements of government contracting.
Internal mechanism for reporting misconduct	Mechanisms, such as a hotline, for employees to report anonymously or confidentially suspected instances of improper conduct and instructions that encourage employees to make such reports. Unless the contract is performed entirely outside the United States or is for commercial items, a contract clause may also be used to require display of agency fraud hotline posters, but the contractor need not do so if it has implemented an ethics program with an internal reporting mechanism, such as a hotline poster of its own.
Disciplinary systems	Follow through with disciplinary action for improper conduct or failing to take reasonable steps to prevent or detect improper conduct; exclude an individual as a principal who has engaged in conduct in conflict with the established code of ethics.
<b>Timely disclosure</b>	In connection with the award, performance, or closeout of a contract or subcontract, mandatory reporting of credible evidence of violations of (1) federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the U.S. Code or (2) the civil False Claims Act. For contracts or subcontracts over \$5 million and a period of performance of 120 days or more, as required by contract clause, they shall timely disclose these violations of federal criminal law and the civil False Claims Act in writing to the agency Office of the Inspector General with a copy to the contracting officer.

Sources: FAR Subpart 3.10, clauses 52.203-13, and 52.203-14 (information); GAO (analysis and presentation).

<sup>1</sup> 73 Fed. Reg. 67064-93 (Nov. 12, 2008).



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# Appendix IV: GAO Contact and Staff Acknowledgments

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John K. Needham (202) 512-4841 or [needhamjk1@gao.gov](mailto:needhamjk1@gao.gov)

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